Supreme Court of the United States

OCTOBER TERM, 1945.

No. 149.

NEVILLE COKE & CHEMICAL COMPANY,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

BRIEF FOR PETITIONER IN REPLY.

JOHN P. OHL,
Counsel for Petitioner,
63 Wall Street,
New York 5, N. Y.

Pandick Press, Inc., 22 Thames St., New York 6, N. Y., U. S. A.

INDEX.

TABLE OF CASES CITED.

STATUTES.

ARTICLES.

Supreme Court of the United States

OCTOBER TERM, 1945.

No. 149.

NEVILLE COKE & CHEMICAL COMPANY,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

BRIEF FOR PETITIONER IN REPLY.

Petitioner would feel remiss in its duty to the Court if it did not point out that the respondent's brief deals with only one of two concepts vital to a decision in the instant case and if it did not call to the Court's attention an excellent recent article by Professor Erwin N. Griswold in the Harvard Law Review entitled " 'Securities' and 'Continuity of Interest'—A Suggestion for the Reexamination of Two Concepts in the Reorganization Provisions of the Tax Laws".

Continuity of Interest Concept Confused with Meaning of "Securities".

Respondent has stated the ultimate question for decision (Br., p. 2) as "whether the notes are 'securities' within the meaning of Section 112(b)(3)". But respondent also

points out (Br., p. 6) that "the basis of the holding of the court below was that the notes did not represent a 'proprietary interest' in the debtor corporation which underwent a recapitalization".

The decision below was thus premised upon what was regarded as a lack of a "proprietary interest" in what was relinquished in the exchange. The concept of "continuity of interest", so called, was, therefore, the real basis of the decision. Yet nowhere in the respondent's brief is there any discussion of the rationale or scope of the continuity of interest concept as applied to the instant case.

The respondent's brief states the question for decision simply as to whether the notes relinquished in the exchange were "securities". Yet throughout the brief references to what this Court has said regarding the continuity of interest concept in interpreting Section 112(g) defining "reorganizations" have been assumed to furnish the criterion for the interpretation of the word "securities" in Section 112(b)(3). No consideration has been given to the argument that as the term "securities" in Section 112(b)(3) has not been defined, it should be given its natural and common meaning.

The following admissions in the respondent's brief make the omission of any reference to the continuity of interest concept the more remarkable:

1. That there has been a reorganization—recapitalization (Br., p. 6);

2. That petitioner received stock and debentures (Br., pp. 4-5), both of which meet the requirements of Section 112(b)(3) with respect to the permitted receipt of "stock or securities";

3. That under *Helvering* v. *Watts*, 296 U. S. 387, where a substantial proportion of stock is received,

> the total consideration received (although a portion gives the holder only a "creditor" rather than a "proprietary" interest), is exempted (Br., p. 7).

Consequently the petitioner's alleged failure to comply with the non-recognition provision has been narrowed by the respondent's other admissions to the simple fact that by happenstance it held a "creditor" rather than a "proprietary" interest prior to the exchange.

The court below, as respondent admits (Br., p. 6) held the notes relinquished by petitioner were not "securities" because they did not represent a "proprietary interest". But no creditor obligation is a "proprietary interest", as was clearly held in *LeTulle* v. *Scofield,* 308 U. S. 415, and it does not transform a "creditor interest" into a "proprietary interest" even if, as in the *LeTulle* case, the "creditor" interest be evidenced by long-term secured bonds.

The respondent clearly feels the embarrassment of the result of the decision below because, after citing what was held (Br., p. 6), an attempt has been made to suggest that the meaning of "proprietary interest" is not clear and then by some unexplained metamorphosis that some evidences of "creditor" interest might be a "proprietary" interest but that "unsecured, temporary evidences of indebtedness which form no part of the capital structure of the corporation" are not. This argument is unsupported assertion.

There is nothing in the record here to support respondent's suggestion that the three, four, and five-year notes which petitioner relinquished were "temporary". Since they were past due and in default at the time of the exchange under the reorganization plan, it is unrealistic to regard them as the equivalent of withdrawable cash at the option of the holder. Moreover, this Court has expressly

stated in the *LeTulle* case, *supra,* that the term of the obligation is immaterial. It is ridiculous to argue under the circumstances here that the notes were "temporary" and therefore not part of the "capital structure", since in fact they were exchanged at a time after the creditors had exercised their rights to control the debtor's affairs.

The Court has in *Helvering* v. *Alabama Asphaltic Limestone Company,* 315 U. S. 179, indicated the only method by which a "creditor" interest can be transformed into the equivalent of a "proprietary" interest. The holding in that case is summarized in *Palm Springs Holding Corporation* v. *Commissioner,* 315 U. S. 185, as follows:

> "The legal procedure employed by the creditors is not material. The critical facts are that the old corporation was insolvent and that its creditors took steps to obtain effective command over its property. For the reasons stated in *Helvering* v. *Alabama Asphaltic Limestone Co., supra,* the creditors at that time acquired the equivalent of the proprietary interest of the old equity owner. Accordingly, the continuity of interest test is satisfied."

Respondent attempts to avoid the full force of the *Alabama Asphaltic Limestone Company* decision by suggesting (Br., pp. 11-12) that the creditors, including petitioner, at no time had the right of control over the debtor company because the stockholders of the debtor acquired new stock in the reorganized company.

Certainly it does not follow that because the creditors did not insist upon their full right to exclude all participation of the old stockholders, they must be regarded as relinquishing their entire control. At most, to the extent that the stockholders participated, the creditors waived their right to full priority *pro tanto.*

Respondent says that *Burnham* v. *Commissioner,* 86 F. (2d) 776, is in conflict with the decision below "only if the court below actually held that shares of stock alone are securities" (Br., pp. 8-9). We submit there is no need to resort to such a strained interpretation of the opinion below on an "only if" stock basis. First, the statutory phrase is "stock or securities". In the second place, the court below clearly stated that its result followed because petitioner gave up in the exchange notes which did not represent a "proprietary interest". No bond, note or other evidence of a debt can give a "proprietary" interest, at least until the creditors enforce their rights as creditors, as was the case in *Alabama Asphaltic Limestone Company, supra.*

Next respondent claims (Br., p. 9) that the *Burnham* case is distinguishable on its facts. What facts make it distinguishable are not specifically stated. Both cases involve unsecured notes. In the *Burnham* case the notes, though not yet due, were payable at the option of the maker, whereas in the instant case the notes were in default and the company insolvent at the time of the exchange. From the standpoint of the possibility of immediate realization of the proceeds of the obligation, the instant case presents an *a fortiori* situation. Both cases involved recapitalizations, and both cases involved identical provisions of the Revenue Act. The only difference is that the notes in the *Burnham* case were ten-year obligations, whereas the notes in the instant case were for three, four and five years when issued. In the light of the *LeTulle* case, *supra,* this is a distinction without a difference. Moreover, the notes in the instant case, when issued, carried with them a right to convert up to 50% of an amount thereof into prior preferred stock of the debtor on or before three years from the date of issue (R. 90-A, 91-A, 92-A). This fact

gives the notes here involved from the outset at least the possibility of being converted into a "proprietary interest". The differences between the facts in the two cases are thus distinctions without essential differences. If anything, the facts in the present case disclose more clearly an original "proprietary interest" than those in the *Burnham* case.

Relation of "Securities" and "Continuity of Interest" Concepts.

The decision below misapplies the continuity of interest concept to what is relinquished. In all previous cases, this Court has applied the continuity of interest doctrine not to what is surrendered or relinquished but only to what is received. Since the decision of the *LeTulle* case, *supra*, it has been settled doctrine that there must be the *acquisition* of a "proprietary interest" in the continuing enterprise. *Helvering* v. *Alabama Asphaltic Limestone Company* and *Palm Springs Holding Corporation* v. *Commissioner, supra*, found the requirement of the continuity of interest doctrine was satisfied where creditor interests were relinquished and there was an acquisition of a proprietary interest in the reorganized venture.

It is a fundamental misconception to argue that what this Court has said regarding the continuity of interest doctrine automatically defines the limits of the word "securities" used in Section 112(b)(3). The true relation between the concepts of what are "securities" under 112(b)(3) and the continuity of interest doctrine has recently been made the subject of a critical analysis by Professor Erwin N. Griswold in the Harvard Law Review entitled "'Securities' and 'Continuity of Interest'—A Suggestion for the Reexamination of Two Concepts in the Reorganization Provisions of the Tax Laws" (Vol. LVIII

Harvard Law Review, p. 705). For the convenience of the Court, Professor Griswold's recent article is reproduced in the Appendix.

The desirability of a consideration by this Court of the issue raised by the instant case is well summed up by Professor Griswold's concluding remark:

> "The argument of this article is that the statute has been denied effect in a situation to which it clearly should apply because of a combination of (1) an original confusion in the *Pinellas* case between the continuity of interest test and the definition of the word 'security,' and (2) a literal and uncritical application of the construction of that word resulting from the confusion. If there is any merit in these contentions, it is not yet too late to recognize that the lowly creditors of a corporation have an interest fully within the purpose of the reorganization provisions of the statute. Bondholders have such an interest. Stockholders have such an interest. Is there any reason at all why noteholders and other creditors, lying in between, should not have exactly the same status?"

Conclusion.

For the reasons stated in the petitions and briefs, the decision of the Circuit Court of Appeals should be reviewed by this Court.

Respectfully submitted,

JOHN P. OHL,
Counsel for Petitioner,
63 Wall Street,
New York 5, N. Y.

THOMAS WATSON,
ROBERT C. BROWN,
Of Counsel.